

Revised by DR/J

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The Soviet Economic System - IIGoals, Capabilities, Limitations, 1959-1975

We now move ahead in our survey to consider the future economic prospects of the Soviet Union -- its goals, capabilities and limitations. In the broadest sense, the goals set for the Soviet economy by the Kremlin leadership reflect the goals of international Communism.

The basic goal is the liquidation of our form of free society and the emergence of a Sovietized world order. The Communist leaders change their techniques as circumstances dictate. They have never given us the slightest reason to hope that they are abandoning their overall objective. They firmly believe, and eloquently preach, that Communism is the system which will eventually rule the world. Each move they make is directed to this end.

Recent Soviet behavior has lead to a popular impression that the East-West struggle has entered a period of reduced cold war tensions. However, any realistic view of East-West relationships must conclude that they remain fundamentally hostile. The Soviet leaders now believe that the Bloc's power position has been enhanced, that the "struggle against imperialism" has entered a promising phase, that the shift in the relation of forces in the world to the advantage of the Communist Bloc is irrevocable. The catchy phrase, "peaceful coexistence" was first used by Stalin in the early 1920's. Then it meant nothing more than a formal acknowledgement

SECRET

- 2 -

that the Industrial West was not about to collapse, as had been freely predicted by Lenin and other now discredited Communist prophets.

Today it means that Khrushchev and his advisers realize the existence of a nuclear near stalemate. So the Red drive has shifted to other arenas, at least for the time being. What is peaceful co-existence? Listen to the words of former Soviet foreign minister Shepilov, and here I quote,

"Peaceful coexistence does not mean a quiet life. As long as different social and political systems exist, contradictions between them are inevitable. Peaceful existence is a struggle -- a political struggle, an economic struggle, an ideological struggle."

Shepilov should have prominently stated that it is also a military struggle.

To be sure, it is not a military struggle in the traditional sense of "cold steel up the beachhead," or active combat. Nor is it a struggle to spend the maximum amount on armaments, which seems to be the objective of some of our own citizens who are loudly beating the drums about a so-called missile gap. Indeed, total Soviet military expenditures have been at a virtually constant absolute level over the past five years. If we wish, we may call this the "Eisenhower effect," remembering the levelling off of defense outlays in the United States.

However, there has been a little noticed, and potentially decisive, explosive growth in Soviet military spending. I refer

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- 3 -

to research and development outlays. While the total Soviet military budget has stood still, r. and d. expenditures are up a staggering 160 percent since 1955. The really important military battle today is being fought in research laboratories, not on the production line, and not in the trenches or on the launching pads.

This is a far less expensive proposition than, say, the mass production of heavy bombers or of first generation ICBM's. At the same time, this concentration gives the Soviets the best chance of resolving the present nuclear stalemate in their favor by developing new weapons systems which would render the existing (or planned) U.S. systems obsolete.

Should the Soviets succeed, should they achieve a breakthrough, I believe they would have compelling reasons to freeze designs, to go into an all-out production program.

Should they succeed in gaining clear-cut military superiority, the Communists would have the weapons for political threat and blackmail, which could prove decisive, even short of a hot war.

There is one line in the fifty page speech that Khrushchev delivered to the Supreme Soviet fourteen days ago that I would commend to your attention above all others. He said, and I quote, "the arms being designed and ... in the portfolios of scientists and designers are fantastic."

To my mind, these are the most revealing words he spoke. In saying this, I do not deny that his statements on the reduction

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- 4 -

of the Soviet armed forces from its present strength of 3.6 million to 2.4 million by 1961 is important information. I also agree that his words, and I quote, "we ... will continue sharply to cut and even discontinue the manufacture of bombers and other obsolete equipment," is significant. However, we already knew that of the eight producing bombers in 1955, only one retained its former rate in 1959, turning out one or two a month. But I would counsel you to remember above all else the Soviet determination to move, full speed ahead, on military research and development.

Short of a military breakthrough, I think we can estimate that the trend of Soviet military spending, through 1965, will be moderately lower. This would mean that the relative burden of defense would be considerably lightened, and possibly that the absolute burden would also decline.

Well, where does Chairman Khrushchev plan to spend the money he saves on military spending? In his landmark speech of 14 January he said,

"The proposal submitted for the government for examination of the Supreme Soviet on the reduction of Soviet armed forces will produce a saving of 16-17 billion rubles per year. This is a great addition for the fulfillment and overfulfillment of our economic plans."

The competition between military programs and investment-economic growth programs for both manpower and machinery has been resolved in favor of economic growth.

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- 5 -

The present Soviet leadership seems to be convinced that the final victory of communism can be won mainly by non-military means. Here the challenge of economic growth is of fundamental importance.

With respect to their intentions, the Soviet leaders have left no room for doubt. The obsession with overtaking the United States economy in the shortest possible historical time period was the dominant theme of the 21st Party Congress, held last February. "The must be surpassed," plastered on every cow barn.

- 6 -

2. You can see that by 1965, the USSR plans to exceed our 1957 levels of production for aluminum, machine tools, electric power generators, and cement.

3. Production of steel and petroleum, while substantial, would still be below present U.S. levels.

Of course, what we have been comparing is 1957 U.S. output with planned Soviet production in 1965. The United States will not be standing still over the next seven years. But our rates of growth will not match those of the Soviet Union. During the decade of the 1950's, Soviet industry grew at the annual rate of about 9-10 percent. This is not the officially announced rate, which is somewhat larger. It is our reconstruction and deflation of Soviet data.

Our own industrial growth for the same period has been at an annual rate of less than 4 percent. This means that, for the decade of the 1950's, the USSR has been moving ahead industrially well over twice as rapidly as has the United States. The Soviets intend to continue this pace.

We are now at a historical period in the race for economic supremacy, the point where the absolute gap between U.S. and Soviet production is beginning to close. A simple way to get a feel for total additions to plant capacity is to compare industrial investment in the two countries.

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- 7 -

easily as those in the past. Every million tons of steel capacity added to existing plants will require the outlay of many more rubles than used to be the case. Even the extensive use of technological innovation will not be able to offset this decline in the productivity of capital. As usual, I have some figures.

(Briefing Aid 3)

1. This chart, covering the 14 year period, 1951-65, is a conversion of rubles to index numbers, using 1951 as a base of 100. You can see that total fixed capital must increase far more rapidly than total output (here measured in gross national product) if the production goals of 1965 are to be met.

2. The bottom line is the ratio of fixed capital to GNP. What this shows is that the productivity of capital dropped about 16 percent between 1951 and 1958, and is expected to drop another 10 percent by 1965. Over the 14 year period then, this is a decline of about 25 percent.

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The Soviets are well aware of this problem. In the Seven Year Plan directive, the investment program is emphasized, alternatively, with plaudits for its enormous size and exhortations for maximum economies in its execution. State investment alone is to total more than two trillion rubles. This sum is claimed to be almost equal to total investment in all the preceding years of Soviet rule. Such a program reflects the continuing need to

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- 9 -

substitute capital for labor if the economy is to be kept growing at rapid rates.

Turning from this brief discussion of investment in the broad, I would like to discuss a closely related problem -- that of managerial incentives. Plant managers in the Soviet Union have been paid primarily by a bonus system, which in turn was based on the physical volume of production achieved during the year. This meant that costs of production were not important in managers decisions. On the contrary, the system was a positive disincentive to introduce new machinery and technology. Inevitably, overhauling a production line implies an initial period of no production while the new equipment is being installed, and a subsequent period of low output while the bugs are being worked out of the line. Therefore, a plant manager who made a radical change in his production facilities, to cut costs and save labor, was penalized financially.

At the same time, widespread mechanization and automation of Soviet industry is needed to meet the output goals of the new seven year plan.

The Central Committee of the Communist Party of the Soviet Union met on this problem during June of 1959. They produced no solutions, but laid down the most thorough-going program of action in this field ever presented in the USSR. The more important directives coming out of this meeting can be summarized as follows:

- 10 -

1. Gosplan and the State Committee for Automation and Machine Building will see to it that all branches of industry work out standardized regulations for developing and testing new machines and handing them over to series production.

2. Gosplan and the Ministry of Finance will work out and submit to the Council of Ministers proposals for improving financial methods for introducing new machines. This would include the setting of prices which would not only stimulate the manufacture of new machines but also their use.

3. Gosplan, the Ministry of Finance and various other government agencies, will prepare proposals for establishing what was called "the necessary economic stimuli" to encourage factories to introduce new technology.

We were not kept in the dark very long concerning the nature of the new "economic stimuli." Between October 1959 and January 1960, new bonus regulations for the Soviet Union's industrial managers, supervisors, and technicians became effective. They covered heavy industry, construction, transportation, communications and state agriculture. The most important provision of the new regulations ^{is the tying of} ~~are they~~ bonuses to reducing production costs, and in certain industries, to improving quality. Bonuses previously paid solely for fulfillment of the production plan have been discontinued.

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- 11 -

By making supervisors and managers cost conscious, and thereby encouraging a more receptive attitude toward new production techniques, the USSR is moving closer to the system of managerial rewards used in capitalist countries.

As I see it, the only alternative available to the Kremlin leadership was to move to a system of far more detailed centralized control. Such a step would have meant that the center in Moscow would prescribe for each plant, the precise technological processes to be introduced, as well as the detailed time table for each re-equipment program. If the Soviet leadership had taken this alternative path, they would have completely reversed the program for decentralization of decision making, which was the heart of the organizational reform of 1957. The bureaucracy in Moscow would be back in the business of making day-to-day operating decisions about the thousands of industrial plants in the Soviet Union. This method of management completely stifled local initiative prior to the reform of 1957.

To move ahead with our survey, I will now turn to the position of the Soviet consumer in the Seven Year Plan. In terms of both consumer goods output and prospective increases in real wages, the Soviet citizen will experience a slower rate of improvement through 1965 than has occurred in the preceding seven years. The output of light industry (textiles, clothing, and footwear) is

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- 12 -

planned to increase at six percent a year. Despite these increases, the volume, per capita output, and quality of Soviet textiles and footwear will remain far below those already achieved in the United States.

The production of durable consumer goods, especially household appliances, is scheduled for large percentage increases. However, the level of output of most such items is currently so low that 1965 production will not be at all impressive by U.S. standards.

In contrast to the plan for industry, where prospects for meeting goals are excellent, the plan for agriculture is unrealistic. The goal, a 70 percent gross increase over 1956, appears impossible of achievement. The quick and easy gains of the past, made possible by the extension of grain acreage into the "new lands," and by the corn program, have no counterparts in future agricultural programs. Our agricultural experts believe that if Khrushchev actually realizes a 30 percent increase (in contrast to the planned 70 percent) by 1965, he will be doing well. Furthermore, the slower growth of agricultural industrial crops, such as cotton, will necessarily limit the increase of manufactured soft goods.

In terms of overall welfare, the Soviet consumer will still be shortchanged. And when the Kremlin leadership promises that the Soviet standard of living will be the highest in the world by 1970, this is absolute nonsense.

SECRET

- 13 -

(Briefing Aid 4)

1. What this chart does is to compare per capita availabilities of certain key components of a consumer welfare index for the U.S. and the USSR. The U.S. Figures are actual 1958 availabilities; the Soviet figures are 1965 planned.
2. Starting off with cloth of all types, including wool, cotton, silk and synthetics, you can see that the Soviets plan to produce less than half the 1958 per capita availabilities in the U.S.
3. Moving on to shoes, the Soviet figure here is 66 percent. However, this statistical comparison favors the Soviet Union, because it omits consideration of quality, and because certain types produced in quantity in the United States, such as women's sandals, are not included in our figures.
4. The much publicized meat goal, of equaling the U.S. by 1960-61 has passed into history. The plan now is to get to nearly half of our 1958 level by 1965. (Not 35% as the chart shows).
5. The last two figures are inventories, not annual production figures, because annual production adds only a small percentage to the inventory. As far as passenger cars are concerned, the Soviets expect to be slightly over one percent of the U.S. per capita level by 1965. Comparing living space, or housing, the Soviet goal is 18 percent of present U.S. available area on a per capita basis. This will provide 7 to 7.5 square meters per person by 1965, which is below the Soviet's own minimum health standard of nine square meters per person.

- 14 -

It is clear that the Soviet Union still regards consumption primarily as a cost of production, required to secure economic growth. Living standards are going to improve, but are not going to be permitted to rise fast enough to interfere with the priority goals of Communism.

So much for the Seven Year Plan, and the prospects for military spending, industrial growth, agriculture and consumer welfare through 1965. I do not wish to leave the impression that the USSR is a nation without problems. However, with the reform of managerial incentives which hit directly at the cost of production problem, and with the reduction in the armed forces, which freed up enough labor and investment resources to insure the success of the seven year plan, I believe the key economic obstacles have been overcome.

Many political problems remain -- those arising from the potentially unstable situation in the European Satellites, from the extremist tendencies and ideological pretensions of Communist China, and from the long-run evolutionary possibilities within the USSR itself, that is, from the aspirations of its own people for a better life and a greater degree of personal freedom. Fortunately for me, these matters are beyond my terms of reference.

I would like to move along, by considering the possible long-term implications of the economic trends we have been considering.

It is important to realize the seriousness of the Soviet challenge; it is equally important not to exaggerate their prospects

- 15 -

in the economic race. In the propaganda surrounding the 21st Party Congress, Khrushchev made a number of statements about Soviet economic power which were nothing more than wishful thinking. Specifically, he stated that,

"After the completion of the Seven Year Plan, we will probably need about five more years to catch up with and outstrip the United States in industrial production. Thus by that time (1970), or perhaps even sooner, the Soviet Union will advance to first place in the world, both in the absolute volume of production and in per capita production." First of all, I would like to start with a projection of total production, or gross national product, in the two countries.

(Briefing Aid 5)

1. You can see that, measured in constant dollars, the Soviet Union's total output grew from about 33 percent of that of the United States in 1950 to 41 percent in 1957.

2. Based on present intelligence estimates, it is believed that their total output will be about half of our own in 1965.

3. Beyond the end of the present planning period, projections are, of course, more risky. I have estimated that the U.S. economy will grow at 3.7 percent a year, which is higher than our long-term rate, and equal to a quite favorable past period of growth. I have projected Soviet growth from 1965 to 1975 at 6½ percent a year, which is below their best postwar growth performance, but

- 16 -

about equal to the achievement of the past two years.

4. If these trends are reasonably accurate, the United States will still command a very large lead by 1970. However, the decade of the 1970's will see the gap closing rapidly, with total Soviet output by 1980 equal to about three quarters of ours.

Moving from total production, which includes industry, agriculture and services, and considering industry alone, the picture for the United States is not so favorable. By 1980 Soviet industrial production will be about equal to our own, and could well exceed U.S. output moderately. Its production of producers goods could be significantly higher than ours, while its output of consumer goods will be significantly less.

All of these forecasts, of course, assume that nothing will happen in the United States to sharply increase our rate of growth, and that nothing will happen in the USSR to sharply decrease that country's economic progress. I conclude that the exaggerations of Soviet propaganda should not blind us to the sobering implications of our prospects in the economic race.

I turn now to the external aspects of Soviet economic growth, to the question of its impact on underdeveloped countries of the Free World.

The Communists believe that the underdeveloped countries represent the Achilles heel of the Western World. These countries have assumed a role similar to that of the proletariat in early

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- 17 -

Marxism. To the Kremlin leaders, the Free World underdeveloped nations offer the greatest opportunities for an extension of Communism; it is the "duty" of the USSR as the vanguard of the revolution to invest some of its resources in promoting this extension.

The tactical shift in Soviet foreign policy to aid the newly emerging bourgeois governments was unveiled to the world in 1954. The party line turned from the "armed struggle" phase of the late Stalin era to a phase of "peaceful coexistence." As part of the "peaceful coexistence" program, the Soviet Bloc began a "trade and aid" offensive.

When the Communist economic offensive started, many Western observers belittled Soviet capabilities to provide aid to underdeveloped nations. These observers believed that internal Soviet requirements for machinery and equipment, generated by the program of forced draft industrialization, would leave no surplus for export.

The judgment overlooked the fact that the Soviet Union had become a major industrial power in the world. By 1955, its annual production of industrial goods was already running over 70 billion dollars a year. Further, industrial output was increasing at an annual rate of nearly 10 percent.

It clearly follows that the Soviets possessed the industrial muscle to step up Communist activities in the Free World by economic

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- 18 -

means; all that was needed was the political decision to do so. A diversion of less than one percent of annual output was enough to support an aid program of significant proportions.

The aid program is not a large one by United States standards. Total credit extensions by the USSR over the past five years have only amounted to about 2.5 billion dollars, and the net annual drain, that is the difference between drawings and repayments, has never amounted to more than half a billion dollars. Eastern European nations and Communist China have extended an additional one billion dollars worth of aid, mostly in the form of credits.

The main point is that of all Soviet outlays for national policy purposes -- defense, industrial investment, etc. -- foreign aid imposes far and away the smallest drain on resources. It could be increased substantially if the Communist leadership saw politically profitable opportunities to do so.

By 1965, the Soviets could have a foreign aid program equal to ours with still no observable strain on its economy. It seems inescapable that the economic competition will grow. This is part of what Khrushchev meant when he told Walter Lippman, "Economically speaking, we will cause you Americans more trouble every year."

Up to this point in time, Soviet Bloc aid to all underdeveloped countries of the Free World has been dwarfed by Western aid. However, it is important to keep in mind that Communist economic assistance is heavily concentrated in a few key target countries.

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- 19 -

In these countries, the Soviet program is either larger than the aid provided by the United States, or is sizeable enough to be of considerable importance. Here are some examples.

(Briefing Aid 6)

1. The bars in this chart compare U.S. aid and Bloc aid from 1954 to the first part of 1959 for selected countries.
2. You can see that in Egypt, Syria, Iraq, Afghanistan, Ceylon and Indonesia, the Bloc has put in far more economic aid than we have. Although not shown in the chart, the same is true for Yemen.
3. In Burma, India, and Nepal, while Bloc economic aid is less than our own, it is nevertheless substantial. This applies to Cambodia as well.

These countries have been willing to expand their economic contacts with the Soviet Bloc for a variety of reasons, but a basic explanation of the success of the Soviet aid program lies in the fact that the underdeveloped countries are capital-starved. Many leaders in these countries, in fact, have voiced their suspicions of Soviet intentions, but have defended their acceptance of Bloc assistance on the ground that the great need for additional capital justified the risk. These leaders are desperately seeking to lead their people into the 20th Century. Rightly or wrongly, they are convinced that industrialization is the true path to economic betterment.

The leaders of world Communism are alert to the opportunity which this great transformation affords them. In their radio

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- 20 -

broadcasts to Africa, the Middle East and Asia, and through their local front organizations, the Soviets project the image of the Soviet system as the magic blueprint for achieving rapid progress. We should not underestimate its attraction.

- 21 -

The Soviet policy of economic penetration fits like a glove into their world-wide campaign of subversion. There are about 6,500 Bloc technicians in the Free World, about 1500 of whom are helping to train military forces and about 5,000 to build various industrial plants, the largest of which is the Indian steel mill. These technicians do not engage in propaganda or in subversive activities. Together with the Communist built plants, these technicians do serve to establish a peaceful Soviet "presence;" to lend credence to Soviet statements of disinterested help in achieving economic progress.

Meanwhile, the Communist propaganda goes out through the front organizations, directed overtly or covertly from Moscow. One of these organizations in India is the Indo-Soviet Cultural Society. Let's take a look at it.

(Briefing Aid 8)

1. You can see that this Indo-Soviet Cultural Society virtually blankets the country.
2. Several of its branches are located in Madhya Pradesh State, where the Russian-built steel mill is being completed.
3. Communist propaganda, similar to the slide I showed you earlier, comparing U.S. and USSR industrial growth, is distributed by such front organizations.

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- 22 -

What you have seen on this slide is only one Communist front organization. But the Soviets and their Chinese Communist allies have organized a vast number of fronts, covering almost every branch of human enterprise. They include youth and student groups, labor and veterans organizations, women's groups, and, of course, the World Peace Council with its innumerable peace societies. In total, the claimed membership of all fronts runs into several hundred million people.

Soviet trade with the underdeveloped nations is motivated primarily by its political impact on the areas concerned. Its ultimate motivation is to export Communism. For example, about a year ago Khrushchev stated,

"Another form of relations is that obtaining between Socialist countries and the economically underdeveloped countries. One may not of course say that in this case that our economic relations are based on mutual advantage. Speaking generally from the commercial viewpoint, our economic and technical aid to the underdeveloped countries is even unprofitable for us. However, aid to the underdeveloped countries is necessary from a viewpoint of humanity and genuine human solidarity."

Translating this from Communist jargon, the Soviet leader is telling us that he is prepared to make a heavy investment to bring the underdeveloped countries into the communist camp. We know

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- 23 -

that the Soviet Union is spending, directly or indirectly, hundreds of millions of dollars each year on these investments in disorder.

To summarize this overly long presentation, let me repeat a few points.

1. The Soviet leaders view the future with confidence.

They believe their military strength, particularly their growing ICBM capabilities, will hold the United States at bay while they make hay in non-military ways.

2. Rapid economic growth and technical progress within the USSR not only provide the industrial muscle to support its national purposes, but also project outward an image of Soviet superiority in the eyes of the Free World underdeveloped countries.

3. The Soviet leaders profess to believe that in ten years time, they will overtake the United States, and their growing economy will take over first place in the world. While this timetable appears premature, the West will be increasingly confronted with the challenge of Soviet economic power, which will make itself felt in a number of unpleasant ways.

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